

Equity Research

Aqua America

WTR: Weather Helps Strong Q3; No Change to '11E and '12E EPS

- Summary.** Strong Q3 helped by weather. '10E EPS increased to \$0.89 from \$0.88. '11E and '12E EPS remain \$0.94 and \$1.00. EPS outlook supported by strong fundamentals. Reiterate Market Perform rating and increasing valuation range to \$21-22 from \$19-20 due to higher group multiple. Our positive bias towards WTR's strategy and EPS growth profile is tempered by valuation considerations. On a forward looking basis, shares trade at roughly 21.5x our '12E, a modest premium to the water utility '12E P/E median of 21x, which we consider warranted given low risk above average EPS growth, consistent dividend growth and financial flexibility.
- Reported Q3 EPS of \$0.32**, above ours and the consensus ests of \$0.29 and \$0.28, vs \$0.25 last year. Primary drivers include favorable weather and rate relief. Usage increased 9% during the period due to hot, dry weather in the east and the Q3 EPS pop was similar to what WTR's neighbor, AWK, reported a day earlier. As expected, O&M accelerated in Q3 however part of the 6.5% increase was associated with a \$1mm write-off and the higher weather-related usage.
- '10E Increased to \$0.89** from \$0.88 to reflect the Q3 beat. While we assume normal weather on a going forward basis, we continue to anticipate solid quarterly EPS through Q2 next year as a result of the significant rate relief implemented in June in PA and NJ. Given accelerating top-line growth, O&M is expected to constitute a lean 39% of revenues and reflects an impressive 150 bps annual decrease since 2008.
- '11E and '12E EPS Remain \$0.94 and \$1.00.** EPS drivers include the usual suspects – rate relief, O&M expense control and opportunistic M&A growth – as mgmt adheres to its proven strategy. Rate awards in '10 amount to \$48.6 mm in annual revenues, roughly half of which is PA. WTR has \$19.1 mm of requests pending with plans to file an additional \$11.5 mm by year-end. We forecast smaller efficiency ratio gains of ~50 bps going forward however this may prove somewhat conservative given mgmt's goal of reaching a 36% ratio in five years. We believe weather normalized average annual EPS growth of 7% is achievable.
- Solid Financial Position.** We forecast operating cash flow will fund over 85% of 2010's \$300 mm CapEx budget. With continued growth in earnings and cash generation, internal DRIP equity should enable slight improvement in the equity ratio to 44% by 2014. WTR has considerable financial flexibility should a significant M&A opportunity arise, particularly at a time when many municipal systems are experiencing financial distress.

Valuation Range: \$21.00 to \$22.00 from \$19.00 to \$20.00

Our VR is based on a relative P/E multiple (applying a 5-10% premium to the '11E group median of 21X to our '12E EPS) and DDM analyses. Risks include regulatory risk, potential undertaking of dilutive growth ventures and deterioration in the water industry's premium multiple relative to electric utilities.

Investment Thesis:

We regard WTR as one of the highest quality, fastest growing water utilities. Strong fundamentals include a growing rate base, largely constructive regulation, a disciplined M&A strategy, relatively low risk EPS growth and a growing dividend. Our Market Perform rating largely reflects valuation considerations.

Please see page 5 for rating definitions, important disclosures and required analyst certifications

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Market Perform

Sector: Water Utilities

Market Weight

Earnings Estimates Revised Up

EPS	2009A	2010E		2011E	
		Curr.	Prior	Curr.	Prior
Q1 (Mar.)	\$0.14	\$0.15 A	NC	NE	
Q2 (June)	0.19	0.22 A	NC	NE	
Q3 (Sep.)	0.25	0.32 A	0.29	NE	
Q4 (Dec.)	0.20	0.21	0.22	NE	
FY	\$0.77	\$0.89	0.88	\$0.94	NC
CY	\$0.77	\$0.89		\$0.94	
FY P/E	28.4x	24.6x		23.3x	
Rev.(MM)	\$671	\$732		\$773	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
 NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
 V = Volatile, ♥ = Company is on the Priority Stock List

Ticker	WTR
Price (11/05/2010)	\$21.89
52-Week Range:	\$15-22
Shares Outstanding: (MM)	137.0
Market Cap.: (MM)	\$2,998.9
S&P 500:	1,226.42
Avg. Daily Vol.:	640,838
Dividend/Yield:	\$0.62/2.8%
LT Debt: (MM)	\$1,450.0
LT Debt/Total Cap.:	54.3%
ROE:	10.0%
3-5 Yr. Est. Growth Rate:	7.0%
CY 2010 Est. P/E-to-Growth:	3.5x
Last Reporting Date:	11/04/2010
	After Close

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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Together we'll go far



Company Description:

Headquartered in Bryn Mawr, PA, Aqua America (WTR) is one of the largest U.S.-based investor-owned regulated water and wastewater utilities. Aqua America, formally Philadelphia Suburban Corporation (PSC), serves approximately 2.8 million residents in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Indiana, Florida, Virginia, Maine, Missouri, and South Carolina. WTR's largest subsidiary, Aqua Pennsylvania, accounts for approximately half of the company's total customer base. The company's aggressive, yet disciplined, growth-through-acquisition strategy has resulted in more than 130 acquisitions and growth ventures adding roughly 250,000 customers over the last five years.

Earnings Model								
(\$ in thousands, except per share data)								
	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Revenues	602,499	626,972	670,539	732,506	773,106	813,065	844,204	881,116
Operating Expenses								
Operation & Maintenance	253,092	262,122	270,060	284,030	295,907	307,136	314,678	324,031
Efficiency Ratio	42.0%	41.8%	40.3%	38.8%	38.3%	37.8%	37.3%	36.8%
Depreciation & Amortization	88,011	94,300	114,939	124,287	131,500	138,565	145,477	152,203
Other taxes	45,380	44,749	48,081	51,275	54,117	56,915	59,094	61,678
Total Operating Expenses	386,483	401,171	433,080	459,592	481,524	502,615	519,249	537,912
Operating Income	216,016	225,801	237,459	272,914	291,582	310,450	324,955	343,204
EBITDA	304,027	320,101	352,398	397,201	423,082	449,015	470,432	495,407
Other Income	6,447	5,273	3,343	5,000	3,000	3,000	3,000	3,000
Interest Expense	66,921	68,572	68,607	75,690	78,276	82,243	79,051	77,623
EBT	155,542	162,502	172,195	202,224	216,306	231,207	248,904	268,581
Income Tax Expense	60,528	64,584	67,842	78,890	85,322	91,283	98,362	106,232
Tax Rate	38.9%	39.7%	39.4%	39.0%	39.4%	39.5%	39.5%	39.6%
Net Income	95,014	97,918	104,353	123,335	130,984	139,924	150,542	162,348
Other Comprehensive Income	0	(14)	294	0	0	0	0	0
Non-Recurring Items	0	0	0	(1,200)	0	0	0	0
Ongoing Net Income	95,014	97,904	104,647	122,135	130,984	139,924	150,542	162,348
Diluted EPS, as reported	\$0.71	\$0.73	\$0.77	\$0.90	\$0.94	\$1.00	\$1.07	\$1.15
Adjustments	\$0.00	\$0.00	\$0.00	(\$0.01)	\$0.00	\$0.00	\$0.00	\$0.00
Ongoing Diluted EPS	\$0.71	\$0.73	\$0.77	\$0.89	\$0.94	\$1.00	\$1.07	\$1.15
Avg. Diluted Common Shares Out	133,602	134,705	136,129	137,736	138,649	139,586	140,536	141,486
Dividends								
Dividends Paid Per Share	\$0.48	\$0.51	\$0.55	\$0.59	\$0.63	\$0.67	\$0.71	\$0.75
Payout Ratio	67%	70%	72%	67%	67%	67%	66%	65%
Statistics								
Year-end BVPS	\$7.32	\$7.82	\$8.12	\$8.51	\$8.91	\$9.33	\$9.79	\$10.28
Average BVPS	\$7.14	\$7.57	\$7.97	\$8.32	\$8.71	\$9.12	\$9.56	\$10.03
Earned ROE, ongoing	10.0%	9.6%	9.6%	10.7%	10.8%	11.0%	11.2%	11.4%
EBITDA Per Share	\$2.28	\$2.38	\$2.59	\$2.88	\$3.05	\$3.22	\$3.35	\$3.50
Free CFPS	(\$1.60)	(\$0.64)	(\$1.00)	(\$0.88)	(\$0.82)	(\$0.77)	(\$0.68)	(\$0.59)
FCF (After Dividends, Before Financing)	(213,639)	(85,769)	(136,803)	(120,671)	(114,361)	(106,998)	(95,694)	(83,464)

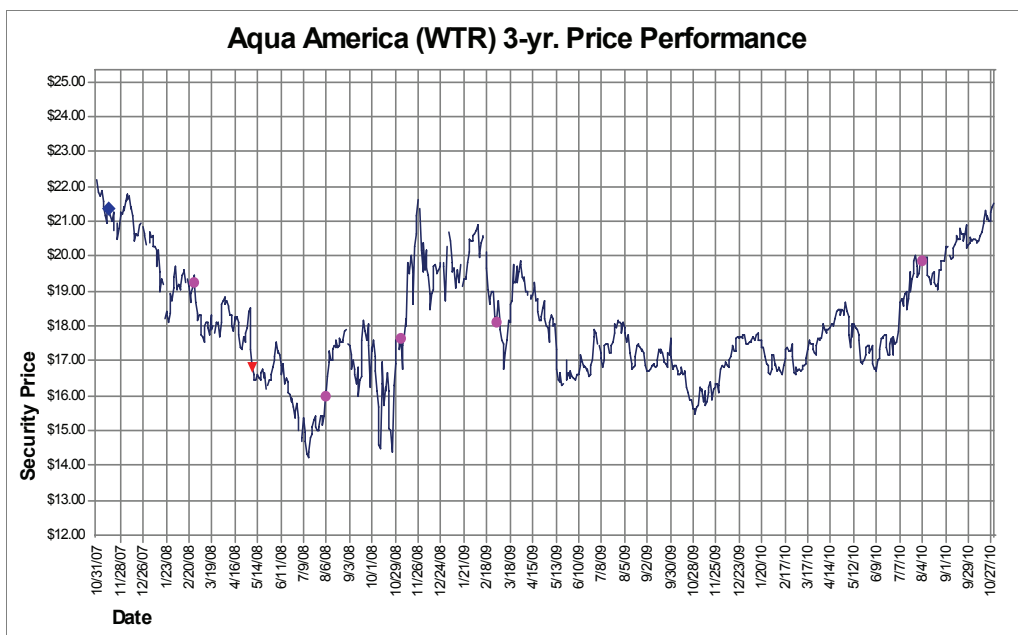
Source: Wells Fargo Securities, LLC estimates and company filings

Utilities

Cash Flow Model (\$ in thousands)	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Operating Cash Flows								
Net Income	95,014	97,918	104,353	123,335	130,984	139,924	150,542	162,348
Depreciation and Amortization	88,011	94,300	114,939	124,287	131,500	138,565	145,477	152,203
Other	11,143	29,288	39,298	20,000	20,000	20,000	20,000	20,000
Net Cash Flows from Operations	194,168	221,506	258,590	267,621	282,484	298,489	316,019	334,551
Investing Cash Flows								
Capital Expenditures	(238,140)	(267,418)	(283,584)	(300,000)	(300,000)	(300,000)	(300,000)	(300,000)
Acquisitions	(51,226)	(14,659)	(3,373)	(7,500)	(10,000)	(12,500)	(12,500)	(12,500)
Other	(54,678)	43,306	(33,707)	0	0	0	0	0
Net Cash Flows from Investing	(344,044)	(238,771)	(320,664)	(307,500)	(310,000)	(312,500)	(312,500)	(312,500)
Financing Cash Flows								
Issuance of Long-term Debt	275,757	52,741	197,855	140,000	120,000	125,000	105,000	150,000
Repayment of Long-term Debt	(46,987)	(39,038)	(20,789)	(55,428)	(28,472)	(39,546)	(34,325)	(87,109)
Short-term Debt, net	(62,232)	23,671	(53,102)	0	0	0	0	0
Common Stock Issuance, net	16,861	46,192	13,280	17,550	18,939	20,424	21,445	22,517
Dividends on Common Stock	(63,763)	(68,504)	(74,729)	(80,792)	(86,845)	(92,987)	(99,213)	(105,515)
Other	741	2,607	6,484	1,500	1,500	1,500	1,500	1,500
Net Cash Flows from Financing	120,377	17,669	68,999	22,830	25,123	14,391	(5,593)	(18,607)
Net Change in Cash	(29,499)	404	6,925	(17,049)	(2,394)	380	(2,074)	3,445
Beginning of Year Balance	44,039	14,540	14,944	21,869	4,820	2,426	2,806	732
End of Year Balance	14,540	14,944	21,869	4,820	2,426	2,806	732	4,177
Capital Structure (\$ in thousands)								
Common Equity	976,298	1,058,446	1,108,904	1,168,996	1,232,074	1,299,435	1,372,210	1,451,561
Long-term Debt	1,215,053	1,248,104	1,386,557	1,471,129	1,562,657	1,648,111	1,718,786	1,781,677
Short-term Debt	80,845	87,886	87,064	87,064	87,064	87,064	87,064	87,064
Minority Interest	1,979	2,181	560	560	560	560	560	560
Total Capitalization	2,274,175	2,396,617	2,583,085	2,727,749	2,882,355	3,035,170	3,178,620	3,320,862
% Common Equity	42.9	44.2	42.9	42.9	42.7	42.8	43.2	43.7
% Long-term Debt	53.4	52.1	53.7	53.9	54.2	54.3	54.1	53.7
% Other	3.6	3.8	3.4	3.2	3.0	2.9	2.8	2.6
Year-end Rate Base	2,399,370	2,569,262	2,741,798	2,903,511	3,060,511	3,212,947	3,358,470	3,497,267

Source: Wells Fargo Securities, LLC estimates and company filings

Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
◆	11/14/2007	22.34	1	24.00	26.00	21.39
●	2/27/2008	19.57	1	22.00	23.00	19.24
▼●	5/7/2008	17.99	2	19.00	20.00	16.80
●	8/6/2008	16.42	2	17.00	18.00	16.01
●	11/5/2008	18.04	2	18.00	19.00	17.65
●	3/2/2009	18.40	2	17.00	18.00	18.13
●	8/4/2010	19.75	2	19.00	20.00	19.87

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

Rating Code Key

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

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As of: November 5, 2010

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